PATEL HOLDINGS SDN. BHD.

v.

ESTET PEKEBUN KECIL SDN. BHD. & ANOR.

HIGH COURT MALAYA, PENANG
WAN ADNAN J
[CIVIL SUIT NO. 22-36-88]
12 NOVEMBER 1988

BANKING: *Performance Bond - Liability to honour unless notice of clear fraud of beneficiary is given.*

CIVIL PROCEDURE: *Interlocutory injunction - Principles of allowing the same - Allegation of fraud not sustained - Serious question to be tried - Balance of convenience.*

The plaintiff had entered into 3 agreements with the National Rubber Smallholders Co-operative Berhad (NARSCO) for the purchase of the Crude Palm Oil. Under each agreement the plaintiff had agreed to provide a security deposit in the sum of RM25,000 in the form of a bank guarantee (provided here by the 2nd defendant) in favour of the 1st defendant for the due performance of the plaintiff's obligations under the agreement.

A dispute arose and the plaintiff in another action (Penang High Court Civil Suit No. 22-145-87) ("the 1st action") made a claim against NARSCO and the 1st defendant.

A consent order was on 21 January 1988 recorded under the 1st action ("the consent order").

The plaintiff by this action sought *inter alia* for a declaration that the plaintiff need not comply with the consent order and that the same be set aside etc and that the 1st defendant be prevented from enforcing or attempting to enforce the guarantees given by the 2nd defendant.

The plaintiff by a notice of motion heard *ex-parte* was granted an injunction *inter-alia* restraining the 2nd defendant from paying any monies to the 1st defendant and the 1st defendant from receiving the same.

The said notice of motion then came up for an *inter partes* hearing.

The plaintiff sought to support their main claim on the basis that the 1st defendant had represented to the plaintiff that time would not be of essence in the terms of the consent order and any requests by the plaintiff for extension of time to perform any of its obligations would be considered favourably by the 1st defendant.

The plaintiff further alleged that if not for this representation they would not have entered into the consent order. The 1st defendant denied these allegations.

In coming to the terms of the consent order both parties were represented by solicitors. 4 drafts contained clauses on default by the plaintiff and the consequences of the same were exchanged.

After the consent order was drawn up the plaintiff had carried out a part of the same and requested for time via a "without prejudice" telex to comply with the other terms on 14 March 1988 and a reply was given only on 16 March 1988. The plaintiff's solicitors contended that the unexplained delay on the part of the 1st defendant in replying to the plaintiff's telex indicated that the representations alleged by the plaintiff were true and hence there was a serious question to be tried.

Held:

[1] The letters of guarantee given by the 2nd defendant to the 1st defendant were in fact performance bonds.

[2] Applying *United Trading Corporation S.A. and Murray Clayton Ltd. v. Allied Arab Bank Ltd. & Ors.* per Ackner LJ:

> *Edward Owen Engineering* is of course the *locus classicus* for the proposition that the performance bond, standing on a similar footing to a letter of credit, obliges a bank to honour it according to its terms, unless it has notice of clear fraud committed by the beneficiary.

[3] The 2nd defendant must therefore honour the guarantees unless it has notice of clear fraud committed by the 1st defendant.

[4] The allegation of fraud must relate to the performance guarantee, not the consent order as alleged. The plaintiff's has therefore failed to make out a serious question to be tried on this point.

[5] The facts showed that the parties had given particular attention to time being of the essence in the consent order and had so agreed to this.

[6] The suggestion of plaintiff's Counsel of a serious question to be tried due to the delay in the 1st defendant's reply to the plaintiff's telex is rejected as this fact should be considered in light of the other facts.

[7] The plaintiff had therefore failed to make out a serious question to be tried.

[8] On the balance of convenience in the event the plaintiff succeeds in this action the plaintiff will be adequately compensated by damages as the defendants or either one of them will be able to comply with any order as to damages.

[Application dismissed with costs.]

Cases referred to:

American Cyanamid Co. v. Ethicon Ltd. [1975] AC 396
Fellows v. Fisher [1976] QB 122
Edward Owen Engineering Ltd. v. Barclays Bank International Ltd. [1978] 1 QB 159
United Trading Corporation S.A. & Murray Clayton Ltd. v. Allied Arab Bank Ltd. & Ors. [1985] 2 Lloyd's LR 554

For the plaintiff - G. Sri Ram (Sri Ram, Zulkifly & Kumar) with K. Kumarendran
For the defendant - S. Kanawagi (Khana & Co.)

JUDGMENT

Wan Adnan J:

In this action the plaintiffs claim for the following orders:

(a) a declaration that the plaintiff is relieved from performing any of its obligations under the consent order dated 21 January 1988;

(b) a declaration that the 1st defendant is not entitled to enforce the guarantees Nos. 87/0425 and 87/0462 both dated 23 July 1987 and issued by the 2nd defendant in the 1st defendant's favour;

(c) rescission of the agreement embodied in the said consent order;

(d) an order that the said consent order be set aside;

(e) an injunction perpetually restraining the 1st defendant from enforcing or attempting to enforce the said bank guarantees or from receiving payment from the 2nd defendant upon the said bank guarantees;

(f) a declaration that the 2nd defendant is not entitled to make payment of the sum of RM500,000 or any sum whatsoever to the 1st defendant upon the said bank guarantees;

(g) an injunction perpetually restraining the 2nd defendant from making payment to the 1st defendant under the said bank guarantees;

(h) general damages for fraud;

(i) interest on damages;

(j) costs;

(k) further or other relief.

By the notice of motion (encl. 2) the plaintiffs had applied for the following orders:

(a) the 2nd defendant, whether by itself or its agents or servants or however otherwise be restrained and an injunction be granted restraining it from making payment of the sum of RM500,000 or any sum whatsoever under the guarantees issued by it on 23 July 1987 and numbered 87/0425 and 87/0426 respectively;

(b) the 1st defendant, whether by itself or its agents or servants or howsoever otherwise be restrained and an injunction be granted restraining it from receiving payment of the sum of RM500,000 or any sum whatsoever under the 2nd defendant's guarantees dated 23 July 1987 and numbered 87/0425 and 87/0426 respectively;

until after the trial of this action;

The motion was heard *ex parte* and I granted the orders in terms of the motion till the date fixed for the hearing of the motion *inter partes*. After hearing both parties I dismissed the application and set aside the *ex parte* order.

The plaintiffs now appeal.

The background of the case is as follow:

1. On 30 August 1987 the plaintiffs entered into three agreements with National Rubber Smallholders Co-operative Berhad (NARSCO) for the purchase of crude palm oil. Under each agreement the plaintiff had agreed to provide a security deposit in the sum of RM250,000 in the form of bank guarantee in the name of Estet Pekebun Kecil Sdn. Bhd. (the first defendant) for the due performance of the plaintiffs obligations under the agreement.
2. Three bank guarantees were given by Malayan Banking Bhd. (the second defendant). They were guarantees No. 87/0583, 87/0425 and 87/0426. The beneficiary under each guarantee was the first defendant.
3. A dispute arose. The plaintiffs then commenced a civil suit in Penang High Court *vide* Suit No. 22-145-87. In that suit NARSCO was named as the first defendant and the first defendant in the present suit was named the second defendant.
4. Subsequently the parties compromised and a consent order was recorded on 21 January 1988.

The principles in *American Cyanamid Co. v. Ethicon Ltd.* [1975] AC 396 were set out by Sir John Pennywick in *Fellows v. Fisher* [1976] QB 122 as follows:

(1) provided that the Court is satisfied that there is a serious question to be tried, there is no rule that the party seeking an interlocutory injunction must show a *prima facie* case.

(2) the Court must consider whether the balance of convenience lies in favour of granting or refusing interlocutory relief.

(3) 'as to that' the Court should first consider whether, if the plaintiff succeeds, he would be adequately compensated by damages for the loss sustained between the application and the trial, in which case no interlocutory injunction should normally be granted.

(4) If damages would not provide an adequate remedy the Court should then consider whether if the plaintiff fails the defendant would be adequately compensated under the plaintiff's undertaking in damages, in which case there would be no reason upon this ground to refuse an interlocutory injunction.

(5) Then one goes on to consider all other matters relevant to the balance of convenience, an important factor in the balance should otherwise be even, being preservation of the *status quo*. By the expression '*status quo*' I understand to be meant the position prevailing when the defendant embarked upon the activity sought to be restrained. Different considerations might apply if the plaintiff delays unduly his application for relief.

(6) Finally, and apparently only when the balance still appears even, it may not be improper to take into account in tipping the balance the relative strength of each party's case as revealed by the affidavit evidence.

The plaintiff's application is supported by the two affidavits of Jugal Kishor Shivlal affirmed on 26 March 1988 (encl. 3) and 14 August 1988 (encl. 9). He is the manager of the trading department of the plaintiff. He and Hemant Patel were present during the negotiations with the officers of the first defendant Chan Yew Cheong and Abdullah Rahman Ismail whom he alleged had orally represented that any request for an extension of time by the plaintiff to perform any of the obligations would be considered favourably by the first defendant. He affirmed that but for that representation neither he nor Hemant Patel would have agreed to the terms which were eventually embodied in the consent order. Both of them were induced to believe and did believe that the first defendant would not insist on time being of the essence despite an agreement by all parties that such a term be included in the consent order. The particulars of representation and fraud were set out in the statement of claim.

The first defendant's case is supported by the affidavits of Abdul Rahman bin Ismail (encl. 6), Mokhtar bin Haji Ngah (encl. 7) and Chan Yew Cheong (encl. 8). All deny the allegations in the plaintiff's affidavits.

The second defendants did not take part in the proceedings.

The injunction sought is to restrain the second defendant from making payment of the sum of RM500,000 under the guarantees numbered 87/0425 and 87/0426 and to restrain the first defendant from receiving the same.

The second defendant had issued the guarantees to the first defendant upon request made by the plaintiff. In order to procure the guarantees the plaintiff gave letters of indemnities to the second defendant.

The letter of guarantee reads:

> In consideration of ... we hereby guarantee you the sum of RM250,000 (Ringgit: Two Hundred and Fifty Thousand only) being security deposit required under the said contract and shall become payable by us on request by you without your having to assign any cause for any request.

In the letter of indemnity given by the plaintiff to the second defendant the plaintiff

> hereby agree and irrevocably authorise you to pay to the guaranteed party the sum guaranteed upon demand by the guaranteed party and we shall at all times hereafter unconditionally indemnify and keep you indemnified ...

The guarantees are in fact performance bonds.

In *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1978] 1 QB 159 at 169, Lord Denning MR stated the laws as to the performance bonds as follows:

> A performance bond is a new creature so far as we are concerned. It has many similarities to a letter of credit, with which of course we are very familiar. It has been long established that when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. Any dispute between buyer and seller must be settled between themselves. The bank must honour the credit ...
>
> All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand; if so stipulated, without proof or conditions. The only exception is when there is clear fraud of which the bank has notice.

In *United Trading Corporation S.A. & Murray Clayton Ltd. v. Allied Arab Bank Ltd. & Ors.* [1985] 2 Lloyd's LR 554, Lord Justice Ackner said:

> *Edward Owen Engineering* [1978] 1 Lloyd's Rep 166; [1978] 1 QB 159, is of course the *locus classicus* for the proposition that a performance bond, standing on a similar footing to a letter of credit, obliges a bank to honour it according to its terms, unless it has notice of clear fraud committed by the beneficiary.

The guarantees in this case are performance guarantees. Therefore the above principles apply. Hence the second defendant is obliged to honour them unless it has notice of clear fraud committed by the first defendant.

The plaintiff is alleging fraud committed by the first defendant in respect of the consent order. In order to prevent the second defendant from honouring its obligations the fraud must be on the performance guarantee itself and not on any other document. The claim on the performance guarantee by the first defendant must be fraudulent. The plaintiff makes no such allegation and there is no evidence that the claim is fraudulent.

I therefore find that there is no question to be tried. The plaintiff is not entitled to the injunction.

In case I am wrong in coming to the above conclusion I will proceed to consider whether the allegation of fraud by the plaintiff gives rise to any serious question to be tried.

The facts leading to the recording of the consent order are clearly set out in the affidavit of Chan Yew Cheong. The parties started negotiations on 28 December 1987. At all times both parties were represented by solicitors. Between 30 December 1987 and 21 January 1988 (the date of the consent order) four different drafts were exchanged. Clause 1(c)(ii) in the consent order which reads:

> The plaintiff shall make the abovestated payments to the defendants within the time stipulated or failing which the plaintiff shall deem to have defaulted

was not in the first draft or the second draft. In the first draft the following paragraph was included:

> In the event of any default by the plaintiff of any one of the instalment payments, the plaintiff shall pay an interest at the rate of 10% per annum on the balance amount due.

The same paragraph appears in the second draft as Clause A(4). On this draft there are markings indicating cancellation. In the third and fourth drafts this clause was replaced by Clause 1(c)(ll) which reads:

> The plaintiff shall make the abovestated payments to the defendants within the time stipulated or failing which the plaintiff shall deem to have defaulted.

which was the clause that was embodied in the consent order. In the third and final draft new clauses were included to make provisions in the event of default.

All these clearly show that the parties had given particular attention to the time being of the essence and had so agreed. If it was true that the officers of the first defendant had said that any request for extension of time by the plaintiffs would be favourably considered the plaintiff would have insisted for and a suitable clause would have been included in the consent order. It must be remembered that the consent order was a compromise after the disputes between the parties had gone to Court and both parties with the assistance of their solicitors would have been very careful not to leave any matter open to any further dispute between them.

The conduct of the parties after the execution of the consent order is also relevant to determine the probability of the plaintiff's allegation of fraud and misrepresentation. By a letter dated 13 February 1988 the plaintiff informed NARSCO that they had truly fulfilled their part of Clause 1(c)(i) of the consent order. The first defendant had been reminding the plaintiff by telex about their obligation under the consent order. There was no reply from the plaintiff until the "without prejudice" telex of 14 March 1988 requesting for extension. Counsel for the first defendant submitted that this telex was not admissible. I found that although it was written "without prejudice" it was not inadmissible. There was no negotiations or attempted negotiations between the parties at that time. It was just a request for extension of time.

The telex was sent at 11.50 a.m. on 14 March 1988. Reply was given only on 16 March 1988. Counsel for the plaintiff submitted that the delay was not explained. He said that if there had been no representation as alleged there should have been no delay and therefore there was a serious question to be tried. I do not agree with this suggestion. This fact should not be considered independently. It must be considered in the light of the other facts which I had stated above.

After considering all the facts I find that there is no serious question to be tried.

I will also consider the balance of convenience in the event that I am held to be wrong in finding that there is no serious question to be tried.

In this case I find that if the plaintiff succeeds in the action they will be adequately compensated by damages for the loss sustained. The two defendants or either of them will be able to comply with any order as to damages.

I therefore dismiss the application with costs.

Also found at [1989] 1 CLJ 229